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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 002183

SIPDIS

DEPT FOR EUR/RUS, FOR EEB/ESC/IEC GALLOGLY AND WRIGHT  
EUR/CARC, SCA (GALLAGHER, SUMAR)  
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TAGS: [EPET](#) [ENRG](#) [ECON](#) [PREL](#) [RS](#)

SUBJECT: CPC UPDATE: EXPANSION MOU "INITIALED", AWAITING  
FINAL AGREEMENT

REF: A. MOSCOW 470  
[¶](#)B. 06 MOSCOW 4691

Classified By: Eric T. Schultz for Reasons 1.4 (b/d)

[¶](#)11. (C) Summary: Chevron Russia Vice President (and CPC Chairman) Andrew McGrahan told us July 28 that Chevron has negotiated a new MOU on CPC expansion with Transneft and Kazakhstan's KazMunaiGaz (KMG). The new MOU has been circulated to other shareholders for approval. McGrahan said the new MOU repeals some objectionable language from a previous MOU, especially regarding the termination of expat secondees. Language on funding the expansion was also changed, with current cash-flow now as the first source, instead of a new tariff on shippers. The MOU also includes a &soft8 commitment to provide 17 million tons of crude to the proposed Burgos-Alexandropoulis Pipeline (BAP). End summary.

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NEW MOU  
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[¶](#)12. (SBU) McGrahan told us that Chevron, Transneft (representing the GOR) and KMG (representing the GOK) initialed an MOU on July 25th setting the framework for long-pending expansion of the CPC pipeline from Kazakhstan to the Black Sea. According to McGrahan, the MOU has been shared with CPC's other shareholders and awaits final approval. Once the MOU is signed, the consortium would have a year to come up with a detailed expansion plan to be executed.

[¶](#)13. (SBU) In May, Transneft and KMG, despite having nearly completed an agreement with Chevron, unexpectedly announced a separate and different agreement that included clauses drastically reducing expat CPC staff in two years and imposing a \$20/ton "investment" tariff on the current CPC shippers to pay for expansion. Chevron found these clauses, especially the removal of expats, unacceptable. McGrahan said the three parties successfully renegotiated the MOU, eliminating these clauses.

[¶](#)14. (C) McGrahan said Chevron may have been able to accept some version of the Transneft/KMG MOU, but that the expat clause was a red line. He said Chevron believes the expats are its main assurance that the pipeline will be built and operated to the quality, safety, operational efficiency, and transparency standards that Chevron would demand of such an

investment.

¶ 15. (SBU) McGrahan said the new MOU also effectively extends for another year the terms negotiated in September 2007 (ref B) which lowered for one year the interest rate on current CPC debt (owed to Chevron, BP, and other shareholders) and raised tariffs on shippers, in order to make the current pipeline financially viable while an expansion agreement was negotiated.

¶ 16. (SBU) Scott Bowen, Chevron's Commercial Manager in Russia, explained that the new MOU calls for expansion to be financed first through current CPC cash-flow instead of the investment tariff on shippers. This spreads expansion costs to all CPC shareholders and not solely to the shippers, including Chevron. An investment tariff could still be imposed, if needed, but only as a third-tier option, after cash-flow and borrowing. He added that a new clause, previously absent, allows CPC to start reserving cash for expansion while the parties negotiate a final plan.

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BP AND OMAN MAY BALK  
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¶ 17. (C) Bowen and McGrahan said they were optimistic that the MOU would be signed soon and that the consortium would sanction expansion within the one year timeline. McGrahan said BP and the government of Oman (one of the original investors) might be the partners with whom negotiations could be difficult. Oman had expected to sell its 7% share to MOL,

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the Hungarian oil company, for \$700 million. McGrahan explained that the GOR and the GOK both wanted to exercise an option to pre-empt the sale to MOL by buying Oman's share themselves. However, the GOK unexpectedly issued a decree making the CPC pipeline a "strategic asset" in Kazakhstan, preventing any sale by Oman of its shares. McGrahan doesn't understand the GOK's move, but expects it relates to a GOK interest in preventing greater Russian ownership of the project. This complication may cause the Omanis to hold up the MOU until the situation is resolved and they allowed to sell their share in the consortium.

¶ 18. (C) BP could be the other potential holdout because it doesn't have any oil to ship through the CPC but owns some \$1 billion of CPC debt. It would therefore prefer to keep both interest rates and tariffs as high as possible.

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BAP  
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¶ 19. (C) McGrahan said the new MOU includes, as did the September 2007 agreement, a commitment on the part of CPC to send 17 million tons of its future capacity of 67 million tons to the proposed BAP project. McGrahan called that commitment "soft," however, noting that it is "subject to acceptable terms."

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COMMENT  
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¶ 10. (C) The new MOU and new optimism on CPC expansion are welcome, especially after Chevron's Eurasia president told us in February that his company had, in effect, "given up" on expansion (ref A). The GOR, having long been the obstacle to expansion, would do well to see this new MOU through and demonstrate to the international business community, especially in these times of doubts about Russia's investment climate, that it can successfully bring a mutually beneficial deal to conclusion.

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